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U.S. International Trade and Competitiveness

The U.S. trade balance has been in deficit for over a decade, raising concern about U.S. competitiveness in world markets. Pessimists believe that U.S. producers are losing markets to their foreign competitors who have the benefit of lower wages, superior technology, and "unfair" trade practices. Proponents of this view typically advocate structural and industrial economic reforms to improve U.S. international competitiveness and greater management of international trade to try to "level" the global playing field.

The appropriateness of such policies depends on whether this diagnosis of U.S. trade problems is valid. This *Letter* examines recent trends in U.S. international competitiveness and trade performance, and argues that U.S. trade deficits are not attributable to low wages or unfair practices abroad. In fact, there are grounds for optimism, though not necessarily for complacency, concerning U.S. international competitiveness and trade performance. U.S. exports have boomed and the trade deficit has declined in the late 1980s, while measures of labor costs and productivity, particularly in manufacturing, indicate resurgent U.S. price competitiveness.

Trade deficits and export growth

International competitiveness is commonly assessed by such measures as movements in a country's trade balance and its share of exports in world markets. Most concern about the U.S. loss of international competitiveness has tended to focus on the U.S. current account and merchandise trade deficits of the 1980s.

Indeed, the U.S. current account, including both goods and services, declined from a $7 billion surplus in 1981 to a peak deficit in 1987 of $160 billion, 4 percent of GNP. Concurrently, the merchandise trade balance declined from a deficit of $28 billion in 1981 to $159 billion in 1987. These increasing deficits were associated with a sharp rise in imports, as exports were relatively flat in the first half of the 1980s.

Since the end of 1986, however, the trade deficit has declined significantly. The merchandise trade deficit was less than $110 billion in 1990 and declined to almost $70 billion in 1991. (The current account deficit declined even more sharply, largely as a result of cash contributions of coalition partners in Operation Desert Storm in the last two years.)

Much of this recent turnabout, particularly during the past year of recession, is attributable to a slowdown of import growth. And, equally important, over the past four years U.S. exports have surged. From 1986 through 1991 the total value of U.S. merchandise exports grew 86 percent, more than 13 percent per year. In volume terms, exports grew almost as fast, averaging more than 11 percent per year. By comparison, in the OECD, excluding the U.S., export volume grew less than 5 percent per year over the same period.

An important source of strength in export growth in the late 1980s has been manufactures, which make up more than 60 percent of total U.S. merchandise exports. According to OECD figures, since 1986 the volume of U.S. manufactured exports has risen about 90 percent, compared with an average rise for other OECD countries of 25 percent. In 1991, as the world economy slowed sharply, exports of U.S. manufactures rose at an annual rate of 7 percent (based on data through the first three quarters of the year), compared with an average increase of just 1½ percent in other OECD countries.

The U.S. export boom has increased America's share of the industrialized world's manufactured exports from 14 percent in 1987 to 18 percent in 1990, not only restoring its share to its level in 1980, but also pushing it ahead of Japan's current 15 percent share. While it cannot be denied that in specific industries,such as automobiles, U.S. firms may continue to face difficult times, the big picture is one of U.S. export resurgence in the late 1980s.

Price competitiveness
International competitiveness also can be assessed by relative changes in a country's production costs and productivity. Changes in unit labor costs, which reflect both changes in labor productivity and wage rates, have a direct effect on the price of goods, and therefore, affect the competitiveness of a country's products in world trade. A smaller increase (or a decrease) in unit labor costs, relative to other countries, improves the price competitiveness of a country's export and import-competing industries.

Is there any evidence of a secular decline in U.S. price competitiveness during the 1980s? During the first half of the 1980s, according to the U.S. Bureau of Labor Statistics, unit labor costs in manufacturing in national currency terms actually rose more slowly in the U.S. than abroad, with the exception of Japan. When measured in dollars, however, unit labor costs abroad fell because the dollar appreciated during the first half of the 1980s. Between 1980 and 1985 unit labor costs in dollars rose at an annual rate of 2.2 percent in the U.S., while falling in 11 of 13 other industrial countries.

This decline in U.S. competitiveness occurred despite strong U.S. productivity growth in manufacturing in the 1980s. Between 1980 and 1985, manufactures output per worker grew 4.0 percent annually in the U.S., compared to 4.0 percent in Japan, 2.3 percent in France, and 2.7 percent in Germany. Thus the appreciation of the dollar in the early 1980s, not underlying cost and productivity changes, caused U.S. manufacturers to lose price competitiveness to foreign producers during this period.

Since the dollar has fallen from its 1985 peak, U.S. unit labor costs have remained constant, while foreign unit labor costs in dollar terms have risen substantially. Costs in Japan, the U.K., France, Italy, Germany, South Korea, and Taiwan, for example, all have risen at more than 10 percent annually over the period 1985–1990. In fact, foreign unit labor costs measured in dollars are now higher than they were in 1980. Thus most of the apparent improvement in U.S. international competitiveness is attributable to changes in the value of the dollar, and at present, manufacturing in the U.S. appears to have a significant cost advantage over manufacturing in other countries.

Unfair foreign practices
While the U.S. trade balance has improved, it remains in deficit. Is the U.S. permanently disadvantaged by "unfair" foreign trade practices abroad, such as government support of selected industries through export subsidies and trade protection? There is ample evidence that virtually all countries, including the U.S., maintain at least some restrictions on imports and provide government support for exports. Nevertheless, there is no evidence that the U.S. trade deficits of the 1980s can be attributed to greater foreign trade barriers or other unfair trade practices.

Lawrence and Litan (1987), for example, have shown that the deterioration in the U.S. merchandise trade balance between 1981 and 1987 was pervasive, across both commodity groups and countries. The decline was uniformly and proportionately spread across capital goods, automotive products, and consumer goods. Similarly, the U.S. trade position deteriorated roughly in proportion to each of its major trading partner's share of U.S. imports and exports in 1981. To account for the turnaround of the overall U.S. trade deficit in the early 1980s, foreign trade practices would have had to change uniformly and suddenly around 1981, an unlikely conspiracy.

Japan, in particular, continues to be frequently singled out as having the most unfair trading practices of all U.S. trading partners. However, it is doubtful that such policies have been a major cause of U.S. trade deficits, particularly since the Japanese market has become somewhat more open over the past decade. Moreover, Japan's share of changes in the total U.S. trade deficit has been proportional to its U.S. trade share. In 1981 Japan accounted for 9 percent of U.S. merchandise exports, 20 percent of U.S. non-oil merchandise imports, and a bilateral deficit (excluding oil imports) with the U.S. of $16 billion. Had these shares been maintained in 1987, the (non-oil) U.S. trade deficit with Japan would have risen to $51 billion, not much below the actual deficit of $57 billion. Applying the same shares to 1990 gives a bilateral deficit of $52 billion, not much different from the actual deficit of $46 billion. Thus restrictive trade practices have not been the driving force behind changes in either the overall U.S. trade deficit or the U.S.–Japan bilateral trade deficit.

Saving-investment behavior
The sharp and pervasive increase of the U.S. trade deficit in the early 1980s suggests that the nature of the change was aggregative or macroeconomic. In fact, that is precisely the case.

By definition, a country's trade balance reflects national patterns of saving and investment. The current account balance equals the difference between national saving (private saving plus government saving, defined as tax revenues minus government spending) and investment. The logic of macroeconomic accounting implies that a country with investment opportunities that exceed its domestic savings will borrow from abroad and run a trade deficit even if its costs are relatively low, its home markets protected, and its exports subsidized. Conversely, a country with high saving relative to investment will run trade surpluses even if its markets are open and its products are regarded as being "noncompetitive."

In the case of the U.S. the emergence and persistence of the large trade deficits since the early 1980s can be largely attributed to changes in the nation's saving-investment balance. Over the 1960s and 1970s the U.S. (gross) national saving rate roughly equaled the investment rate and remained constant at 19 to 20 percent of GNP. In the early 1980s, however, the saving rate fell by 3 percentage points, largely as the result of large government budget deficits, while investment fell 1 percentage point. The resulting net saving deficit led to the appreciation of the dollar and the associated current account deficits that emerged in the early 1980s. Declines in the budget deficit since 1987 have contributed to a subsequent decrease in the net saving and current account deficits.

Thus further macroeconomic policy adjustment, ideally through either a fiscal contraction or an increase in private saving (or, less ideally, through a reduction in domestic investment) is needed to accommodate further improvement in the trade balance over the long run. Improved U.S. international price competitiveness alone is insufficient.

Looking ahead

An overly pessimistic view concerning U.S. competitiveness in world markets is unjustified. U.S. exports have boomed and the trade deficit has declined in the late 1980s, while measures of labor costs and productivity, particularly in manufacturing, indicate resurgent U.S. price competitiveness. U.S. productivity growth in the 1980s has been comparable with, and in some cases better than, other industrial countries. The continued existence of U.S. trade deficits reflects an imbalance of national saving above investment, not any fundamental decline in U.S. international competitiveness.

Of course, too much complacency is unwarranted; to sustain its productivity growth performance over the long run the U.S. must pursue policies that will foster greater private capital formation, increased investment in infrastructure, expanded research and development expenditures, improved educational quality, and entrepreneurial activity. But thinking that the U.S. is uncompetitive and "over the hill" can create undue attention for inappropriate short-term economic solutions, such as greater protectionism, managed trade policy, or industrial targeting, particularly during the current period of macroeconomic stress.

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Reference

Lawrence, Robert, and Robert Litan. 1987. "The Protectionist Prescription: Errors in Diagnosis and Cure." *Brookings Papers on Economic Activity* 1.

Monetary Policy Objectives for 1992

Federal Reserve Chairman Alan Greenspan presented a report to the Congress on the Federal Reserve's monetary policy objectives for 1992 on February 19. The report includes a summary of the Federal Reserve's monetary policy plans along with a review of economic and financial developments in 1991 and the economic outlook in 1992. Single or multiple copies of the report can be obtained upon request from the Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120; phone (415) 974-2246.

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